Wealth redistribution, not tax cuts, key to economic growth

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President Trump's new tax plan will follow the familiar script of reducing taxes for the rich in the name of job creation. Not only will these trickle-down policies not work—they'll make the problem worse. A new report by a team of complexity scientists demonstrates an alternative: Increase wages to create more investment opportunities for the wealthy, thus creating new jobs and a stronger economy.

In the 10 years since the financial crisis, despite massive economic interventions and zero interest rates, unemployment rates have only now returned to pre-crisis levels. Poverty and debt continue to be widespread, and economic growth struggles to reach 3 percent.

The new complexity science analysis describes the flows of money through the economy, not just the overall activity. It shows that there are two cycles of activity that have to be balanced against each other. The first is that workers earn salaries and consume goods and services. The second is that the wealthy invest in production and receive returns on their investments. The two loops have to be in the right balance in order for growth to happen. If there is more money in the worker loop, there aren't enough products for them to purchase. If there is more money in the investment loop, consumers don't have enough money to buy products so investment doesn't happen.

The paper shows that before 1980, there was too much money in the worker/consumer loop. That money was chasing too few products, giving rise to dangerously increasing inflation. After 1980, likely because of the Reaganomics tax changes, the balance tilted the other way. There was too much money in the investor loop and the result was a series of recessions. The Federal Reserve repeatedly intervened by lowering interest rates to compensate workers' low wages with increased borrowing, in order to increase consumption.

The research shows that the way the government is regulating the economy is like driving a car with only the accelerator and without using the steering wheel. Steering means keeping the balance between the two loops in the right proportion. While Federal Reserve interventions have helped overcome the recessions, today, we are up against the guardrail and need to rebalance the economy by shifting money back to the labor/consumer loop.

Since 1980, consumers have accumulated trillions of dollars of debt, and the wealthy have accumulated trillions of dollars of savings that is not invested because there is nothing to invest in that will give returns. This is the result of government policy reducing taxes for the wealthy in the name of increasing economic activity. No matter how much money investors have, these so-called "job creators" do not create jobs when consumers don't have money to buy products. Increased economic activity requires both investment and purchase power to pay for the things the investment will produce.

The research shows that Reaganomics had the right idea at the time, but there is need today for a new, bold policy change in the opposite direction. The economy will grow if the flow is shifted toward workers/consumers and away from wealthy investors. The work cautions, however, that this has to be done in the right amount. Reaganomics moved things too far toward the wealthy, so shifting the flow in the other direction has to be done in the right measure.

The results suggest that current approaches to correcting economic problems by reducing government spending (austerity), while decreasing taxes for the wealthy to promote investment, are misguided. They may have been good policies in 1980, but they are long outdated today. It turns out that economic inequality is not just a social justice problem, but actually an economic problem. Fixing economic inequality will have dramatic benefits for economic growth.

More information: Preliminary steps toward a universal economic dynamics for monetary and fiscal policy, *New England Complex Systems Institute* (October 10, 2017). necsi.edu/research/economics/econuniversal

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